Year-Round Tax Planning for More Flexible Financial Decisions

True tax planning doesn't begin and end at filing time. At Fathom Advisors, we make it an ongoing part of the financial planning process because tax decisions can influence financial outcomes just as much as investment decisions. Our approach focuses on creating flexibility before a tax decision becomes urgent. Rather than focusing on single tax decisions, we build a coordinated strategy that can adapt from year to year.

BUILDING FLEXIBILITY ACROSS THE TAX TRIANGLE

When we evaluate retirement savings, we look beyond the total account balance and consider where the money sits. We organize assets into three tax buckets: Taxable accounts that hold money on which taxes have already been paid, tax-deferred accounts (e.g., 401(k)s and traditional IRAs), and tax-free accounts like Roths. We refer to this framework as the tax triangle.

The tax-deferred bucket often becomes the largest because contributing pre-tax dollars can lower taxable income today. The tradeoff comes later, when you pay ordinary income tax on withdrawals. If nearly all retirement assets sit in that one bucket, a retiree may have less control over the tax cost of future spending.

Holding money across all three buckets can create more flexibility. Each year, we review taxes, other income, Medicare premiums, and spending needs before helping a client decide where to draw funds. That flexibility can be incredibly valuable when an unexpected expense or meaningful goal arises.

One client came to us with most of their savings in a tax-deferred IRA and a goal of taking the entire family on a cruise. Funding the trip from a pre-tax account meant withdrawing enough to cover both the vacation and the resulting taxes. After seeing the full amount, the client decided not to take the trip. The tax burden changed the decision. Greater balance across the tax triangle can help keep a goal like that from becoming a tax problem.

CHOOSING WHEN TO PAY TAXES THROUGH ROTH CONVERSIONS

A Roth conversion moves money from a tax-deferred account, such as a traditional IRA, into a Roth IRA. You pay the tax at the time of conversion rather than later, so the planning consideration is about determining when paying them may create the best outcome.

If we believe someone may face a higher tax bracket later, we'll evaluate whether a conversion during a lower-income period could create meaningful savings over time. Required minimum distributions, potential tax-rate changes, and reduced control over future income can all affect that decision.

We worked with a retired couple after the husband, who had primarily managed their finances, became terminally ill. They had a large IRA and no Roth assets. We compared their current tax position with the future period when the wife would file as a single taxpayer. Based on that analysis, we helped them complete two years of sizable Roth conversions before the husband passed away.

CREATING A THOUGHTFUL RETIREMENT WITHDRAWAL STRATEGY

Once someone retires, the question is not only how much to withdraw. It is which account(s) should provide the money and in what order. That decision ties directly to the tax triangle.

The right sequence can change from year to year. A retiree may continue receiving variable income from a business or employment. Deferred compensation may create scheduled payments during the first several years of retirement. We account for those income sources when deciding where withdrawals should come from.

Retirement age also impacts the strategy. Someone retiring at 62 faces a different planning window than someone retiring at 67 or 70. Social Security timing, Medicare eligibility, and the number of years before required minimum distributions can all affect the approach.

IMPROVING TAX EFFICIENCY THROUGH ASSET LOCATION

We distinguish between asset allocation and asset location. Allocation describes what you own, including the mix of stocks and bonds. Location describes which types of accounts hold those investments.

Consider someone with a moderately aggressive 60/40 allocation and assets in all three parts of the tax triangle. We would not automatically make every account 60/40. More conservative holdings may fit better in the bucket subject to higher tax rates. More growth-oriented investments may fit better in the bucket with more favorable tax treatment. The broader principle is simple: some investments work more efficiently in taxable accounts, while others may fit better in tax-advantaged accounts such as an IRA or Roth.

USING NET UNREALIZED APPRECIATION

Net unrealized appreciation, or NUA, applies in a specific situation involving highly appreciated company stock inside a 401(k) or other employer retirement plan, typically with a sizable balance. Instead of rolling that stock into an IRA with the rest of the account, the strategy allows the shares to move into a taxable brokerage account. The investor pays ordinary income tax on the original basis. When they eventually sell the shares, the remaining growth receives long-term capital gains treatment.

The ability to use NUA depends on technical requirements. The distribution structure and timing both matter, as does qualification as a lump-sum distribution. An execution error can eliminate the benefit, which makes careful planning essential.

MAKING CHARITABLE GIVING MORE TAX EFFICIENT

Charitable planning can be part of a year-round tax strategy. A donor-advised fund allows a person to combine several years of giving into one year and take the full deduction upfront. The donor can then distribute the money to charities over time.

A donor-advised fund can accept highly appreciated securities. We can review a portfolio for holdings with sizable unrealized capital gains and identify specific lots to contribute when appropriate. This can improve both the value and tax efficiency of the giving strategy.

Qualified charitable distributions, or QCDs, offer a different approach for people over age 70 1/2 who have an IRA. Once someone becomes eligible, a QCD can be a more efficient way to give to charity than writing a check or using a donor-advised fund.

BUILDING FLEXIBILITY INTO YOUR FINANCIAL FUTURE

Tax planning is ultimately about creating more options. The decisions you make today about where you save, when you recognize income, and how you draw from your assets can shape the choices available to you years from now. By considering taxes in the context of your overall financial life, you can create greater flexibility and avoid letting tax consequences dictate what you can—or cannot—do when the time comes.

FREQUENTLY ASKED QUESTIONS

How Can I Reduce Taxes on My Retirement Withdrawals?

Where you withdraw money from can affect how much you ultimately keep. Having assets across taxable, tax-deferred, and tax-free accounts can provide more flexibility to choose where retirement income comes from based on your tax situation each year.

What Should I Do with Highly Appreciated Company Stock in My 401(k)?

In certain circumstances, net unrealized appreciation (NUA) may allow company stock to be moved from an employer retirement plan into a taxable brokerage account, potentially allowing some of the appreciation to receive long-term capital gains treatment. This strategy has specific requirements, so timing and execution matter.

What's The Most Tax-Efficient Way to Donate Appreciated Stock to Charity?

Depending on your circumstances, donating appreciated securities through a donor-advised fund can provide an upfront charitable deduction while potentially avoiding realization of the embedded capital gain. For eligible IRA owners, qualified charitable distributions may offer another tax-efficient way to give.

Which Retirement Accounts Should I Withdraw from First?

There isn't one withdrawal sequence that works for every retiree. Income, age, Social Security, Medicare, deferred compensation, and the timing of required minimum distributions can all influence which accounts make sense to draw from in a given year.